

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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to:

(Chief, Business Adjustment Section)  
SE:W:CAS:AM:PPG:B

from: Phyllis E. Marcus

(Chief, International Branch 2)  
CC:INTL:B02

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subject: Legality of Abatement of Civil Penalties Under Section 6038

This is in response to your request that we provide advice as to whether the same criteria used for a reasonable cause determination made by Accounts Management (AM) for abatement of the section 6651(a)(1) failure to file penalty with respect to a late Form 1120 can be used for the abatement of the section 6038 civil penalty with respect to a late Form 5471.

#### BACKGROUND

Section 6012(a)(2) of subchapter A of chapter 61 requires every corporation subject to taxation under subtitle A to file a return with respect to income taxes. Form 1120 is used for corporate income tax reporting and to comply with section 6012(a)(2). All domestic corporations generally must file Form 1120. Section 6651(a)(1) imposes a penalty for failure to file any return on the date prescribed (including any extension of time for filing) unless it is shown that the failure is due to reasonable cause and not due to willful neglect.

Form 5471 is a return used by certain U.S. citizens and residents who are officers, directors, or shareholders in certain foreign corporations in order to satisfy their reporting obligations under sections 6038 and 6046 and the related regulations. Form 5471 is used for information reporting, not tax reporting. Dollar penalties and penalties of reduced foreign tax credits are imposed under section 6038(b) and (c) for failure to

file the information required by section 6038(a) within the time prescribed. Section 6038 (c)(4) provides that for purposes of the section 6038(b) and (c) penalties, the time prescribed under section 6038(a)(2) to furnish information (and the beginning of the 90-day period after notice by the Secretary) shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary) reasonable cause existed for failure to furnish such information. Section 6038 does not include a provision defining reasonable cause for failure to furnish the required information within the time prescribed.

## ANALYSIS

Reasonable cause is based on all the facts and circumstances in each situation and allows the Service to provide relief from a penalty that would otherwise be assessed. Relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining their tax obligations but is unable to comply with those obligations. See IRM 20.1.1.3.1(1). Nonassertion or abatement of civil penalties based on reasonable cause must be made in a consistent manner. See IRM 20.1.1.3.1(2). The language of reasonable cause provisions vary. Some penalty provisions also require evidence that the taxpayer acted in good faith (e.g. section 6664(c)(1)) or that the taxpayer's failure to comply with the law was not due to willful neglect (e.g. section 6651(a)(1)). The section 6038 reasonable cause provision does not include the additional requirement "and not due to willful neglect" that is part of the section 6651 reasonable cause provision.

Failure to file a Form 1120 within the prescribed time ordinarily generates a section 6651(a)(1) penalty unless the taxpayer satisfies the applicable reasonable cause standard. As noted above, section 6651 imposes a penalty *unless it is shown that the failure is due to reasonable cause and not due to willful neglect*. Treas. Reg. §301.6651-1(c) discusses a showing of reasonable cause for purposes of the failure to file penalty and provides that if the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to reasonable cause.

Failure to file a Form 5471 information return generates penalties under section 6038. Neither the statute, nor the regulations under section 6038, defines reasonable cause for failure to timely file a Form 5471. IRM 20.1.1, as well as other analogous regulations (e.g. Treas. Reg. §301.6651-1(c)) suggest standards for evaluating reasonable cause. IRM 20.1.1.3.1.2(2) provides factors to consider to determine whether the taxpayer exercised ordinary business care and prudence. Those factors include taxpayers' reasons, compliance history, length of time, circumstances beyond the taxpayers' control, and in some cases ignorance of the law or inability to get records. It is our understanding that AM's decision tree for imposing penalties for late filing of Form 1120 is based upon such factors.

The reasonable cause standard mandated by section 6651 requires the taxpayer to affirmatively establish that the failure was due to reasonable cause and not willful

neglect. Although taxpayers are not required to demonstrate that failure to file was not due to willful neglect for Form 5471, the considerations (e.g. exercise of ordinary business care and prudence) discussed above would constitute valid considerations for abating a failure to file timely Forms 5471. Also, there should be consistency in applying the penalty if a taxpayer failed to file both its Form 1120 and the Form 5471.

## CONCLUSION

We conclude there is no legal rule or internal policy prohibiting AM from using the same criteria to abate the section 6038 penalty for a late filing of Form 5471 where AM has abated the section 6651(a)(1) failure to file penalty for the late Form 1120 using the reasonable cause criteria in IRM 20.1.1.3.1. Also, there is no legal reason why the same criteria could not be used even where the Form 1120 was timely filed, but the Form 5471 was not. The irrelevance of reasonable cause with respect to one form does not preclude a reasonable cause determination with respect to the other form. Thus, for example, if the Form 1120 was timely filed, but the Form 5471 was not, a reasonable cause determination may be made with respect to the failure to file Form 5471 even though reasonable cause is irrelevant with respect to the timely filed Form 1120.